U.S. Natural Gas Price Behavior Counterintuitive

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Market Hotline
U.S. natural gas prices aren't behaving the way they are supposed to.

The rationale for the recent rise in gas prices goes beyond the appellation of "contraseasonal." Given the currently ample state of natural gas storage in the U.S., perhaps a more accurate description of the gas market direction might be "counterintuitive."

A key influence of course is the surge in oil prices that persists with continuing restraint among oil exporters and with continuing hostilities in the Middle East coming amid rebounding oil demand. That alone has pushed a sizable chunk of demand among the fuel-switchable crowd back to gas.

Uncertainty

But part of upward pressure on gas prices seems to be a thing apart from what is happening with oil markets. Uncertainty is the order of the day.

As Energy Security Analysis Inc., Boston, noted in a late April research note, "Natural gas funds seem to have gotten a bit ahead of their oil brethren in a move that has either ulterior motives due to pending contact expiration or is a deliberate attempt to keep this market strong and continuously supported above where one would think the fundamental factors would allow.

"Weather looks a touch bullish in the coming weeks, but all that blasted gas in the ground remains plentiful and not likely to disappear anytime soon. Technical signals are flashing green lights, however."

The upshot, according to ESAI, is that "this market could explode or implode either way....

Some of the market uncertainty also stems from the handoff of gas storage data tracking from the American Gas Association to the U.S. Energy Information Administration, formally scheduled to occur May 9, with data reflecting the preceding week. The data will be made available at EIA's web site at http://tonto.eia.doe.gov/oog/info/ngs/ngs.html every Thursday morning. There will be no lapse in coverage of this crucial market indicator, as AGAs final survey was released on May 1 and covered data the week prior. The uncertainty here stems from the different methodology and the different sampling of companies surveyed that EIA uses vs. AGA's. The changes could create potentially false indicators of the relative health of the US gas market, according to Simmons & Co.

International, Houston, in a recent analysis (OGJ, Mar. 25, 2002, p. 35).

Back to basics

For all this uncertainty, it seems that a return to fundamentals is in order in trying to parse the mysteries of the natural gas market today.

The recent heat wave across much of the US has buried what little remained of the residual heat load demand. The National Weather Service's latest 6-10 outlook at the outset of May called for higher- than-normal temperatures across much of the country. But still there were pockets of heating demand persisting as April wound down, and the last injection into storage reported by AGA was a mere 38 bcf. Those factors combined to bring the year-over-year storage surplus down to 690 bcf from 754 bcf the previous week and 728 bcf the week before that.

Consequently, UBS Warburg analyst Ron Barone predicted in a May 2 research note, "...the industry will likely realize material surplus contraction as EIA's data [are] released throughout May." Barone estimated that industry would have to inject 47-58 bcf/ week to get storage to the historical minimum level of 2.8-3.1 tcf by the start of the next heating season on Nov. 1. That compares with the prior 7-year average of 71 bcf/week.

So while storage conditions remain a lingering depressant on the market, the U.S. rig count continues to rise, driven by those rigs drilling for gas. Will price-induced drilling opportunism be enough to offset the storage surplus as we glide through the cooling season and shoulder months? If history repeats, it will.

Funny thing about this year's market, though, is that uncertainty tends to breed self-fulfilling prophecy. All this uncertainty over gas prices is leading operators to shift cash flow to debt reduction, stock buybacks, and asset acquisitions instead of to drilling. That could further dampen the urge to drill despite the lure of high prices. And the market could tighten after all.

After Sept. 11 and the Enron Corp. debacle, uncertainty may be the hottest commodity of all.

by Bob WiIIiams, Executive Editor
(Online May 3, 2002; author's e-mail: bobw@ogjonline.com)

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